

Internal Revenue Service

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Person To Contact:

Telephone Number:

Refer Reply To:
CC:INTL:B05
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Date:
August 01, 2016

Legend

A =
CFC 1 =
CFC 2 =
Country A =
Parent =
US Sub =
Corp A =
Corp B =
W% =
Corp C =
X% =
Partnership A =
Y% =
Z% =
Regulator =
Day X =

Dear :

In a letter dated A, you requested a ruling allowing CFC 1 and CFC 2 (collectively, the "CFCs") to use certain foreign statement insurance reserves in computing foreign personal holding company income under section 954 on the grounds that these insurance reserves are an appropriate means of measuring income within the meaning

of section 954(i)(4)(B)(ii). Specifically, you requested permission to use the underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves for life insurance and annuity contracts reported by CFCs on their Country A Annual Report.

The rulings given in this letter are based on facts and representations submitted by Parent and accompanied by a statement executed under penalty of perjury by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Facts

Parent is a publicly-traded domestic corporation that is engaged, through its subsidiaries, in various lines of business, which primarily include life insurance, accident and health insurance, credit insurance, annuities, endowment and retirement and savings products. Parent directly and indirectly owns all the stock of US Sub. US Sub owns all the stock of Corp A. Corp A owns all the stock of Corp B. Corp B owns W% of Corp C. Corp C owns X% of the interests in Partnership A. Partnership A owns Y% of CFC 1 and Z% of CFC 2. CFC 1 and CFC 2 were both formed under the laws of Country A. Parent represents that CFCs are controlled foreign corporations as defined in section 957. CFCs are both engaged in the life insurance business in Country A and their principal products are traditional life, universal life, group life, credit life and fixed annuities.

Country A regulates any insurance business conducted in Country A through its insurance laws and regulations. Regulator developed and is responsible for enforcing insurance laws and regulations in Country A. An insurance company must obtain a license from the Regulator to conduct an insurance business in Country A.

CFCs are licensed by the Regulator to sell life insurance and annuity contracts to residents of Country A and are subject to regulation by Regulator as a life insurance company. CFCs derive more than 50 percent of their aggregate net written premiums from the issuance of life insurance and annuity contracts covering applicable home country risks. No policyholder, insured, annuitant, or beneficiary to a life insurance or annuity contract that the CFCs issue is a related person as defined in section 954(d)(3). CFCs do not carry on business other than life insurance and certain activities that are incidental to the life insurance business. Parent has represented that CFCs would be subject to tax under Subchapter L if they were domestic corporations.

As required by Country A's insurance laws and regulations, CFCs file an Annual Report and financial statements with the Regulator. The Annual Reports are audited by an external accounting auditor in addition to the company's internal auditor. The accounting records of CFCs that form the basis for preparing the Annual Report are subject to

inspection by the Regulator at any time. The Annual Reports are made available to the public. The Annual Reports are used for financial purposes in addition to regulatory purposes, such as for Country A credit rating purposes, by lenders, and by the public. Day X is the official year-end for life insurance companies operating in Country A.

To comply with Country A's insurance laws and regulations, CFCs must establish and maintain certain reserves for obligations to holders of their life insurance and annuity contracts and must report the amount of such reserves on the Annual Report. The reserves at issue in the ruling request are (1) underwriting reserves; (2) loss reserves; (3) policyholders' dividend reserves; and (4) premiums paid in advance reserves that the CFCs maintain on their Country A Annual Reports for life insurance and annuity contracts.

CFCs have appointed a qualified actuary to be involved in matters designated by the Regulator as actuarial matters, including the method of calculating reserves. The actuary has knowledge and experience concerning actuarial matters for a company in Country A engaged in the insurance business

The reserve system for Country A includes the following requirements as to assumptions and method with respect to life insurance and annuity contracts including those issued by CFCs.

Underwriting reserves are required to secure the performance of future obligations arising from life insurance contracts. Underwriting reserves are comprised of insurance premium interpolated terminal reserves, unearned premium reserves, and risk reserves. The sum of insurance premium reserves and unearned premium reserves (referred to as the "standard valuation reserve") for life insurance and annuity contracts may not be less than the amount calculated in accordance with the designations of the Regulator concerning the reserve method, interest rate, mortality rate and other coefficients. The Regulator requires life insurance and annuity reserves to be determined as follows: (1) the prescribed reserve method to be a method analogous to the Commissioner's reserve valuation method in form, although not identical in amount; (2) the prescribed standard annual interest rate assumption; and (3) the prescribed mortality tables.

CFCs also hold: (1) loss reserves for outstanding claims (including incurred but not reported claims) under life insurance and annuity contracts issued by the CFCs and calculated using the company's individual loss experience, in accordance with rules and regulations prescribed by the Regulator; (2) policyholders' dividend reserves, which comprise policyholders' dividend reserves and policyholders' profit dividend reserves. Policyholders' dividend reserves are reserves for dividends that have been declared and that have been credited, or will be credited at the next policy anniversary date, to policyholders, and that have not been withdrawn by policyholders. Policyholders' profit dividend reserves are reserves with respect to certain dividends that are not yet

reflected in the policyholders' dividend reserves; and (3) premiums paid in advance reserves which include any premium that has been paid but whose due date falls in the following year.

Parent represents that: (1) CFCs are not engaged in any insurance business outside of Country A and do not carry on non-life insurance business; and (2) each contract covered by the rulings requested is a life insurance contract or annuity contract for federal income tax purposes, without regard to sections 72(s), 101(f), 817(h) and 7702.

The reserves covered by this ruling do not include: (1) deficiency reserves; (2) contingency reserves; (3) equalization reserves; (4) excess interest reserves for excess interest credited beyond the end of the taxable year; (5) reserves for administrative expenses (including guarantees intended to cover future expenses associated with the payment of claims such as bank fees or inflation risk); (6) underwriting or loss reserves for non-cancellable and guaranteed renewable accident and health contracts; (7) reserves for any amount to protect against a future decline in the value of investment assets; or (8) any reserves for accrued liabilities.

Law

In general, a United States shareholder of a controlled foreign corporation ("CFC") must include in gross income its pro rata share of the CFC's Subpart F income for each year. Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954.

Section 953(a)(1) defines the term "insurance income" to include any income which is attributable to issuing or reinsuring of an insurance or annuity contract, and which would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953(a)(2) provides that section 953 insurance income does not include "exempt insurance income" derived by a "qualifying insurance company." Section 953(b)(3) provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

Section 953(e)(1) defines exempt insurance income as income derived by a qualifying insurance company which is attributable to the issuing (or reinsuring) of an exempt contract by such company and such income is treated as earned by such company in its home country for purposes of such country's tax laws. Exempt contracts are defined under section 953(e)(2) to include insurance or annuity contracts issued by a qualifying insurance company in connection with the lives or health of residents of a country other than the U.S. but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3).

In general, section 953(e)(3) defines a “qualifying insurance company” as any controlled foreign corporation which:

(A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country;

(B) derives more than 50 percent of its aggregate net written premiums from the issuance by such controlled foreign corporation of contracts covering applicable home country risks of such corporation and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3); and

(C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 954(a)(1) defines the term “foreign base company income” to include, among other types of income, foreign personal holding company income. Section 954(c)(1) sets forth the types of income that are considered to be foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company”.

Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. First, income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section 954(i)(4)). Second, income received from unrelated persons and derived from investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts.

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserves under section 954(i)(4)(B)(i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in

determining the foreign statement reserve provide an appropriate means of measuring income.

Section 954(i)(4)(B)(ii) was originally enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, 12/18/2015), section 954(i) was permanently extended and made effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end. In its Technical Explanation to the PATH Act, the staff of the Joint Committee on Taxation explains section 954(i)(4)(B)(ii) as follows:

The provision does, however, permit a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve for such contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Joint Comm. on Taxation, Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40) (JCX-144-15 (December 17, 2015)).

Analysis

CFC 1 and CFC 2 are subject to regulation as life insurance companies by Country A. CFC 1 and CFC 2 are licensed, authorized, and regulated by the Regulator, which is the insurance regulatory body for Country A, to sell life insurance and annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in Country A. Parent has represented that CFC 1 and CFC 2 each derive more than 50 percent of their aggregate net written premiums from the issuance of life insurance and annuity contracts covering risks in connection with the lives or health of residents of Country A and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)). Finally, Parent has represented that CFC 1 and CFC 2 are engaged in the life insurance business and would be subject to tax under Subchapter L if they were domestic corporations. Accordingly, CFC 1 and CFC 2 are QICs.

CFC 1 and CFC 2 issue life insurance and annuity contracts in connection with the lives and health of residents of Country A, a country other than the United States. CFC 1 and

CFC 2 derive more than 30 percent of their net written premiums from contracts that cover Country A risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Such contracts are, therefore, exempt contracts within the meaning of section 953(e)(2).

CFC 1 and CFC 2 must establish, maintain, and calculate their reserves in accordance with rules prescribed by the Regulator. The Regulator generally requires a life insurance company to determine the amount of its reserves based on guidance provided by the Regulator. CFC 1 and CFC 2 must set forth their reserves on the Country A Annual Report, which must be filed annually with the Regulator. As such, the reserves are the measure of the legal obligations to policyholders on the financial statement used for regulatory purposes by life insurance companies doing business in Country A generally (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries). The Regulator requires CFC 1 and CFC 2 to hold reserves for the fulfillment of claims owed to policyholders and beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. Under the rules prescribed by the Regulator for determining reserves required to be calculated for purposes of the Country A Annual Report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

Ruling

Based on the information submitted and the representations made, we rule as follows:

Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves maintained by CFC 1 and CFC 2 with respect to its exempt life insurance or annuity contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC 1 and CFC 2 under section 954(i).

Caveats

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling. This ruling will be subject to revocation if any of the following circumstances occurs: (1) a change in the material facts on which this ruling was based; (2) a material change in the business circumstances of CFC 1 or CFC 2 which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to the current reserving method of CFC 1 or CFC 2.

Procedural Statements

This ruling is directed only to CFC 1 and CFC 2. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Mark E. Erwin
Branch Chief, Branch 5
Office of Associate Chief Counsel (International)

cc: